



STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

Audit of Expenditures
For the Quarter Ended September 30, 2003

Internal Audit Report No. 05-5

AUDIT DIVISION
Department of
Accounting and General Services
April 1, 2005

EXECUTIVE SUMMARY

The Department of Accounting and General Services, Audit Division conducted an audit of the Department of Commerce and Consumer Affairs' (the Department) expenditures for the quarter ended September 30, 2003 to determine whether expenditure payments made by the Department are legal, recorded to the proper account, in compliance with applicable laws, rules and regulations, policies and procedures, and established accounting and internal control systems.

The mission of the Department is to administer and oversee activities for professional and vocation licensing, business registration, cable television, financial institutions and insurance industries. The Department conducts administrative hearings, protects and advances the interest of the consumer of regulated utilities and transportation services through consumer advocacy activities. The Department also investigates consumer complaints of unfair or deceptive trade practices, and investigates and prosecutes complaints relating to industries regulated by the Department.

With respect to the audit of the Department's expenditures, we noted the following:

- Five professional services awards were not in compliance with Section 103D-304(i), Hawaii Revised Statutes (HRS), which requires the award to be posted electronically within seven days of the award date by the chief procurement officer.
- A laptop computer purchased at a cost of \$1,179.99 was not reported to the State Procurement Office as required by Section 103D-1206, HRS.
- One check, totaling \$1,600.00 was paid after the 30 days allowed under Section 103-10, HRS. No interest was calculated and paid to the vendor due to the late payment.
- Purchase orders supporting 8 checks, totaling \$14,955.13, were prepared after the receipt of the related vendor invoice. The established accounting system requires purchase order forms be prepared prior to receiving the vendor invoice to document authorization to purchase specified merchandise or the rendering of certain services.
- Two checks of \$3,000.00 each were paid for the same expense. The original payment was supported by the original vendor's invoice. The duplicate payment was supported by the vendor's monthly statement. Payments should only be supported by an original vendor's invoice as required under Section 40-56, HRS.

We recommend that the Department establish controls to comply with the above statutory sections and the State's established accounting system.

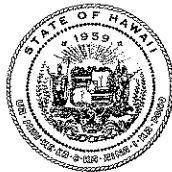
In response, the Department concurred with Audit Findings No. 1 and No. 2, did not concur with No. 3, and partially concurred with No. 4 and No. 5.

STATE OF HAWAII
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

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INTRODUCTORY SECTION



STATE OF HAWAII
DEPARTMENT OF ACCOUNTING
AND GENERAL SERVICES

P.O. BOX 119
HONOLULU, HAWAII 96810-0119

05.0086

April 1, 2005

The Honorable Mark E. Recktenwald
Director
Department of Commerce and Consumer Affairs
State of Hawaii
335 Merchant Street, Room 310
Honolulu, Hawaii 96813

In accordance with the provisions of Section 26-6 of the Hawaii Revised Statutes, I present you with a financial audit report on the Department of Commerce and Consumer Affairs' expenditures for the quarter ended September 30, 2003.

The report is presented in two sections: introductory and noncompliance. The introductory section includes this transmittal letter, a summary of services, introduction, background, scope, objectives, methodology, and audit procedures performed. The noncompliance section includes a schedule of audit findings with recommendations.

Sincerely,

A handwritten signature in cursive script that reads "Russ K. Saito".

RUSS K. SAITO
State Comptroller

SUMMARY

The Department of Accounting and General Services (DAGS), Audit Division conducted an audit of the Department of Commerce and Consumer Affairs' (the Department) expenditures for the quarter ended September 30, 2003 to determine whether expenditure payments made by the Department are legal, recorded to the proper account, in compliance with applicable laws, rules and regulations, policies and procedures, and established accounting and internal control systems.

INTRODUCTION

Authority to conduct this audit resides in Section 26-6, Hawaii Revised Statutes (HRS), which authorizes after-the-fact audits to determine the legality of expenditures and the accuracy of the accounts. In addition, Section 40-2, HRS, requires the State Comptroller to ensure that all accounting and internal control systems of departments in the executive branch of the State government adhere to prescribed policies and procedures and accounting principles generally accepted in the United States of America.

This audit is part of the Audit Division's 2004-2005 Audit Plan. The Audit Division maintains its organizational independence in accordance with section 3.27, Independence Standards, *Government Auditing Standards* (2003 Revision).

Audit fieldwork took place October 1, 2004 through December 8, 2004 at the DAGS' Pre-Audit Branch and the Department's fiscal office. The Audit Division's staff conducted the audit, under the direct supervision of Steven J. Lee, Supervising Auditor, under the supervision of Wayne L. Chu, CPA, Audit Division Administrator.

BACKGROUND

The Department was created in 1959 by the Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959) as the Department of Treasury and Regulation. The primary function of the Department is to set standards and enforce all laws, rules and regulations governing the licensing and operation of trades, business and professions.

The Department administers and oversees activities for professional and vocation licensing, business registration, cable television, financial institutions and insurance industries. The Department conducts administrative hearings, protects and advances the interest of the consumer of regulated utilities and transportation services through consumer advocacy activities. The Department also investigates consumer complaints of unfair or deceptive trade practices, and investigates and prosecutes complaints relating to industries regulated by the Department.

SCOPE, OBJECTIVES, AND METHODOLOGY

The audit includes an examination of expenditures paid by the Department during the period July 1, 2003 through September 30, 2003. The audit objectives are to determine the legality of expenditures, accuracy of accounts, and the Department's compliance with established accounting and internal control systems.

This report includes detail testing of a sample of expenditure transactions and does not include the Department's other financial transactions, such as payroll expenditures, cash receipts and journal vouchers (JVs). The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

A listing of the Department's expenditures for the quarter ended September 30, 2003, from the State's Financial Accounting and Management Information System, was used for sampling and verification to source documents during the audit. The Department processed for payment 3,810 expenditure transactions totaling \$9,476,163.01 during the quarter ended September 30, 2003.

We examined 50 randomly selected expenditure transactions, totaling \$232,551.24, as outlined below:

	<u>Total Population</u>	<u>Sample</u>	
		<u>Count</u>	<u>Amount</u>
Expenditures	\$ 642,033.78	25	\$ 89,047.26
Contract expenditures:			
Professional service	769,440.43	19	126,796.14
Others	122,922.53	6	16,707.84
Payroll expenditures and JVs	<u>7,941,766.27</u>	<u>-</u>	<u>-</u>
Totals	<u>\$9,476,163.01</u>	<u>50</u>	<u>\$232,551.24</u>

To gain an understanding of the Department's procedures in processing expenditures for payment and documenting the internal control system related to those procedures, we interviewed appropriate personnel, reviewed applicable available written policies and procedures, and documented our understanding of the established accounting system and internal controls in place during the audit period.

AUDIT PROCEDURES PERFORMED

We reviewed documents supporting expenditures such as vendor's invoices, purchase orders, summary warrant vouchers, requisition forms, procurement documents, contracts and inventory

Department of Commerce and Consumer Affairs
Audit of Expenditures Report

records to determine compliance with applicable laws, rules and regulations, policies and procedures, and compliance with established accounting and internal control systems.

Based on our detail testing of expenditure transactions, we found 25 expenditures and 25 contract expenditures to be legal expenditures of the Department, properly recorded and processed by the Department, and in compliance with established accounting and internal control systems, except for the 5 audit findings presented in the noncompliance section of the report.

NONCOMPLIANCE SECTION

AUDIT FINDINGS WITH RECOMMENDATIONS

The procedures enumerated below were performed to determine whether payments made by the Department are legal, recorded to the proper account, in compliance with applicable laws, rules and regulations, policies and procedures, and established accounting and internal control systems.

AUDIT FINDING NO. 1 – PROFESSIONAL SERVICES – POSTING OF AWARD

Section 103D-304(i), HRS, states that contracts awarded under this section for \$5,000 or more shall be posted electronically within seven days of the contract award by the chief procurement officer or designee and shall remain posted for at least one year. The State Procurement Office (SPO) established a database of professional services awards on its website to assist departments and State agencies to satisfy this statutory requirement and electronically post their contract awards.

We noted five professional services contract awards that did not document compliance with Section 103D-304(i), HRS, in the project files. The Department's Information Systems and Communications Office procured two awards in 2002. The Department's Cable Television Division, Insurance Division and the Professional and Vocational Licensing (PVL) Division procured three awards in 2001 and 2002. The project files had no evidence the awards were electronically posted within 7 days of the date of the award.

In 2001 and 2002, SPO's website did not display the posting date of the professional services awards. In January 2005, SPO modified its presentation of professional services awards to include the posting date. However, the awards made in 2001 and 2002 are no longer on the current SPO's listing of professional services awards.

Procedures Performed

We interviewed the Department's staff that participated in the procurement of the five professional services awards. We examined the contract project files. We reviewed the SPO's website of professional services awards and examined the SPO's files for awards archived and removed from the website.

We found evidence that one award was electronically posted 7 days after the date of the award. For the remaining four awards, we did not find evidence that the awards were electronically posted within 7 days of the date of the award.

Recommendation

The Department shall establish a control to comply with Section 103D-304(i), HRS. A copy of the document showing complete compliance with this section shall be placed in the project file.

AUDIT FINDING NO. 2 – PROPER RECORDING OF CAPITAL ASSETS

Section 103D-1206, HRS, requires departments and State agencies to report annually the costs of capital assets purchased during the fiscal year to the SPO.

The Insurance Division purchased a laptop computer at a cost of \$1,179.99. This expenditure meets the State's policy of recording the laptop computer as a capital asset of the State. The Insurance Division did not report the laptop computer as a capital asset to the State Procurement Office as required under Section 103D-1206, HRS.

Procedures Performed

We interviewed the fiscal officer of the Department and examined the division's detail listing of inventory of property. The fiscal officer and employees responsible for the input acknowledged that the laptop computer was not reported. We examined the Insurance Division's annual report (Annual Summary of Inventories Report – AGS Form 17B) to the SPO for the fiscal year 2004. The laptop was not included in the annual report to the SPO for the fiscal year 2004.

Recommendation

The Department shall establish a control to comply with Section 103D-1206, HRS. The Insurance Division shall report the cost of the laptop computer to the State Procurement Office as required by Section 103D-1206, HRS. Failure to comply with this section will result in penalties as stated in Sections 103D-1209 and 103D-1210, HRS.

Section 103D-1209, HRS, states that if any officer, head of department, agent, employee, or other person fails to file the required inventory within the time prescribed, the SPO's administrator shall withhold the salary or wage due the officer, head of department, agent, employee, or other person until the inventory is filed.

Section 103D-1210, HRS, imposes a \$500 penalty or imprisonment of not more than six months for any officer, member of a public board, assessor, or other person who fails to perform any of the duties imposed upon the person by these sections.

AUDIT FINDING NO. 3 – INTEREST EXPENSE ON LATE PAYMENT TO VENDORS

Section 103-10, HRS, states that vendors shall be paid no later than 30 calendar days following receipt of the statement (vendor's invoice) or satisfactory delivery of the goods or performance of the services. Interest at the rate equal to the prime rate plus two percent (not to exceed twelve percent) shall be paid from the 30th day following receipt of the statement or satisfactory delivery of the goods or performance of the services, whichever is later and ending on the date of the check.

Department of Commerce and Consumer Affairs
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The PVL Division approved an invoice of \$1,600.00 on June 6, 2003 and paid it on July 10, 2003, a total of 34 days. Interest was not calculated and paid to the vendor.

Procedures Performed

We interviewed the fiscal officer of the Department. We examined the vendor's invoice and compared the check date to the attestation statement date by the authorized employee certifying satisfactory delivery of goods or performance of services. We found that the number of days between the check date and the invoice approval to pay date exceeded 30 days.

Recommendation

The Department shall establish a control to comply with Section 103-10, HRS, to ensure that payments to vendors are made no later than 30 calendar days following the date of the attestation statement by the authorized employee certifying satisfactory delivery of the goods or performance of the services rendered. If payments cannot be made within the 30 calendar days, as described in Section 103-10, HRS, the interest shall be calculated and paid to the vendor.

**AUDIT FINDING NO. 4 – PURCHASE ORDERS PREPARED AFTER THE RELATED
VENDOR INVOICE RECEIVED**

Section 40-2, HRS, establishes the accounting system used by State departments. The State's Accounting Manual describes in detail the accounting system. The State's accounting system uses purchase order forms to document authorization to purchase specified merchandise or the rendering of certain services. The control is the authorized state employee that approves the purchase of the goods or services by signing and dating the purchase order.

We found purchase orders supporting eight checks totaling \$14,955.13 that was prepared after the receipt of the related vendor invoice. Four checks totaling \$9,495.54 from the PVL Division; two checks totaling \$3,408.78 from the Insurance Division; one check for \$74.88 from the Regulated Industries Complaint Office; and one check for \$1,975.93 from General Support.

Procedures Performed

We interviewed the fiscal officer of the Department. We examined the purchase orders, vendor invoices, and summary warrant vouchers for the eight checks. We compared the purchase order dates, authorizing the purchase, to the related vendor invoice dates. We noted in each case that the purchase order date was after the invoice date. This is not in compliance with the State's established accounting system.

Recommendation

The Department shall establish a control to comply with Section 40-2, HRS, and the State's Accounting Manual, and prepare purchase orders, in accordance with established policies and

procedures, to authorize the purchase of goods and services before the goods and services are delivered or rendered.

AUDIT FINDING NO. 5 – EXPENDITURE PROCESSED WITHOUT AN ORIGINAL INVOICE

Section 40-56, HRS, and the State Accounting Manual, require that vouchers for payment be supported by “original bills” (invoices). The reason for this requirement is to prevent a duplicate payment for the same goods/services.

Two checks of \$3,000.00 each were paid for the same expense of the PVL Division. The original payment was supported by the original vendor’s invoice. The duplicate payment was supported by the vendor’s monthly statement. A refund for the duplicate payment was subsequently received from the vendor.

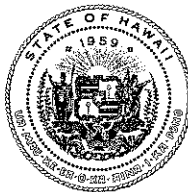
Procedures Performed

We interviewed the fiscal officer of the Department. We examined the purchase orders, vendor’s invoice and vendor’s monthly statement that supported the expenditures.

Recommendation

The Department shall establish a control to comply with Section 40-56, HRS, and the State Accounting Manual, and expend funds only when supported by an original invoice.

DEPARTMENT'S RESPONSE



LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

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MARK E. RECKTENWALD
DIRECTOR

LAWRENCE M. REIFURTH
DEPUTY DIRECTOR

March 28, 2005

The Honorable Russ K. Saito, Comptroller
Department of Accounting and General Services
1151 Punchbowl Street
Room 412
Honolulu, Hawaii 96813

Re: Audit of DCCA Expenditures for the Quarter Ended September 30, 2003;
Internal Audit Report No. 05-5

Dear Comptroller Saito:

The Department of Accounting and General Services, Audit Division (DAGS) has conducted an audit of this department's expenditures for the quarter ended September 30, 2003. Audits such as this are helpful in identifying areas where attention might profitably be focused. The Department of Commerce and Consumer Affairs (DCCA) appreciates the work of DAGS' staff in conducting the audit, the benefits that we will derive from it, and this opportunity to comment.

Response to Issues Identified in Internal Audit Report No. 05-5.

Based on our review of the draft audit and our subsequent discussion with members of your staff, we understand that there are five categories of observations.¹ We will address these in the order presented in the Executive Summary.

- **Five professional services awards were not in compliance with section 103D-304(i), HRS, which requires that the award be posted electronically within seven days of the award date by the chief procurement officer.**

¹ A draft of the report was provided by facsimile on March 1, 2005. An amended Audit Finding No. 4 and a newly drafted Audit Finding No. 5 were subsequently emailed to the department. We note only for the record that we have not been provided with a copy of the single document to which we are being asked to respond. We believe, however, that we are responding to what will be contained in the final report.

<u>Division</u>	<u>Contractor</u>	<u>Type</u>
Information Systems	Data House Consulting, Inc.	Professional Services
Information Systems	Data House Holdings Corp.	Professional Services
Cable Television	Squire, Sanders & Dempsey, LLP	Legal Services
Insurance	Muetterties Bennett & Associates, Inc.	Legal Services
Professional Vocational Licensing	Cades Schutte Fleming & Wright	Legal Services

The issue involves the lack of any evidence that the contracts were posted as required by the law. No one contends that the contracts were not posted as required, only that there is no evidence, more than a year later, that demonstrates that they were.

Under the department's policy, which implements the DAGS policy, each of the contracts should have been posted within seven days of their award. In addition, reasonable management practices would include documentation of the posting in the contract file. These files are kept within the control of each of our divisions. The divisions are assigned responsibility for posting the contracts and reflecting the fact of posting in the contract files. As such, we have sent a departmental policy memorandum to each of our divisions, reminding them of their obligations to (1) post all contracts within seven days of award, including legal services contracts which are technically awarded by the Department of the Attorney General, and (2) print out copies of the posting from the DAGS/SPO website, and place that copy in the contract file.

- **A laptop computer purchased at a cost of \$1,179.99 was not reported to the State Procurement Office as required by section 103D-1206, HRS.**

This, in fact, occurred. The computer was purchased immediately prior to the department's move from the Princess Kamamalu Building to the King Kamehameha Building in November 2003. Insurance Division staff packed up the newly acquired computer and the related paperwork (which instructed them to tag the computer and place it on the division's inventory list) for the move. Upon relocation, staff unpacked the computer, but did not unpack the paperwork for some time. As a result, the computer was not listed on the inventory as it should have been.

The department's divisions are assigned responsibility for maintaining inventory records. As such, they are required to reflect on their reports all inventory as required by section 103D-1201, HRS. The department then takes that information and provides it to

the SPO. The person responsible has been counseled and the department has reiterated its policy by means of a departmental policy memorandum to each of our divisions, reminding them of their obligation to (1) list all inventory on the division's inventory list in the same quarter that payment is made, (2) present that inventory on a timely basis, and (3) amend the inventory listing as soon as any errors in the report are noted.

- **One check, totaling \$1,600.00 was paid after the 30 days allowed under section 103-10, HRS. No interest was calculated and paid to the vendor due to the late payment.**

Payment to the National Association of State Boards of Accountancy (NASBA) was indeed made more than 30 days after the invoice was dated. No interest was calculated or paid to the vendor.

The department believes that section 103-10, HRS does not apply to the NASBA purchase order because the purchase order was not rendered "pursuant to a contract," nor was it rendered pursuant to a contract for goods or services. NASBA is a national regulatory organization. It offers membership to regulatory agencies with oversight over the licensing of accountants. There is no "contract" for annual membership, and NASBA is not invoicing us for delivered goods or services. There is no specified due date and we are not assessed a late payment fee at any time. We believe that DAGS errs in applying the interest paid requirement of section 103-10, HRS to the payment of undated membership dues, and request that the DAGS Audit Review Committee consider the matter, and provide further guidance to the other executive departments.

- **Purchase orders supporting 8 checks, totaling \$14,955.13, were prepared after the receipt of the related vendor invoice. The established accounting system requires purchase order forms be prepared prior to receiving the vendor invoices to document authorization to purchase specified merchandise or the rendering of certain services.**

The revised draft report identifies eight checks that were prepared after receipt of the related vendor invoice:

Division	Contractor	Type
Professional Vocational Licensing	American Association of Dental Examiners	Membership dues
Professional Vocational Licensing	National Council of Architectural Registration Boards	Membership dues

Professional Vocational Licensing	National Council of Architectural Registration Boards	Membership dues
Professional Vocational Licensing	Community Associations Institute Hawaii Chapter	Seminar sponsorship
Insurance	Booke Seminars	Seminar attendance fee
Insurance	Honolulu Police Department	Annual criminal history records Check fee
General Support	Xerox	Lease payment
Regulated Industries Complaints Office – Maui	Big Dogs Air Conditioning & Refrigeration LLC	Air conditioning repair

The eight checks were indeed prepared after the invoices were received. Three of these checks, however, were again for membership in national regulatory organizations.² As in the prior case, the rule relating to preparation of purchase orders prior to invoice receipt has no logical application in the case of membership dues. That understanding was confirmed for us – in advance – through a telephone call for advice to DAGS/Pre-Audit, which agreed with our position on the issue.

The rule appears equally inapplicable to the case of the two seminar invoices. In the first case, the invoice represents the department's share of its sponsorship of the seminar. That share was not determinable until after the seminar occurred, because it depended on the total number of attendees and determination of the related printing/postage costs for which we were responsible. The second case involved an employee's attendance at a work-related seminar. The invoice was paid approximately 30 days before the seminar, and the travel was approved by me approximately two weeks before that. No goods or services were received prior to preparation of the purchase order, and no liability was incurred prior to receipt of approval. This is not a case where the invoice represents the receipt of goods or services.

The sixth incident involves the department's payment to the Honolulu Police Department for use of the HPD criminal history records check system throughout FY03. While some portion of those services had been received prior to receipt of the invoice (dated September 10, 2003), the HPD charge for this service had not been determined

² The third check was an inadvertent duplicate of the second check, and it was subsequently rescinded. It is the department's position that since the initial payment is not or should not be governed by the purchase order before vendor invoice rule, neither should the inadvertent duplicate payment.

until the invoice was prepared. Since FY03 was the department's first year with the program, and we only had a partial year's experience and charge at that time, it was not possible to use FY03 expense as the basis for estimating the same for FY04. In this particular case, it was impossible to reasonably estimate the charge and prepare a purchase order in advance of the invoice. The department requests that the Audit Review Committee consider the application of the purchase order before vendor invoice rule to the seven cases described above and provide further guidance to the other executive departments.

The seventh check represents a lease payment by the department. The rule that purchase orders should precede invoices applies as well to lease payments, and the department attempted to comply with it by means of a purchase order dated June 9, 2003. This preceded the invoice by almost one month. Unfortunately, the program did not have sufficient funds in its account to make full payment. As a result, some portion of the amount owed remained pending until the FY04 fiscal year, and the purchase order for the remainder could not be prepared prior to receipt of the invoice for the full amount (dated July 2, 2003).

The final incident represents payment on an invoice for air conditioning repair service in our Maui office. The incident reflects an error by department personnel. The person responsible has been counseled, and a departmental policy memorandum has been issued, reminding responsible employees of the need to prepare purchase orders prior to receipt of goods or services.

- **Expenditure processed without an original invoice.**

This represents a second issue related to the duplicate membership fees payment discussed above in footnote 2. While the department agrees that the processing of this invoice a second time was clearly a mistake, we note that the rule is difficult to enforce, except after the fact, due to the ever-improving quality of copier machines. The department's error, we believe, stems not so much from processing the expenditure without an original invoice, but from the failure to follow department protocols relating to handling of the initial invoice.

Summary

Thank you for your staff's work in identifying these issues. We concur with many of the audit findings, and have taken steps to remind staff of the principles involved and the procedures that we have in place to prevent reoccurrences. If you have any questions, please do not hesitate to contact me. If there is anything further that you believe that we should do, please let me know.

The Honorable Russ K. Saito
March 28, 2005
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Sincerely,

A handwritten signature in black ink, reading "Mark E. Recktenwald". The signature is written in a cursive, flowing style.

MARK E. RECKTENWALD

c: Kay Okimoto, DCCA Fiscal Officer